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Supreme Court of the United States

October Term, 1965

No. 414

In the Matter of
IRA HAUPT & Co.,
a Limited Partnership,

Bankrupt,

BERNARD KLEBANOW, GEORGE LEWIS, MICHAEL SLOAN and HAROLD L. MARANTZ, KENNETH ALAN MARANTZ and EDITH LEE MARANTZ, as Executors of the Estate of Charles Marantz, and LAZARUS S. HEYMAN,

Petitioners,

THE CHASE MANHATTAN BANK and MANUFACTURERS HANOVER TRUST COMPANY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENTS

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Respondents.

BRIEF IN OPPOSITION FOR RESPONDENTS

Question Presented

Are limited partners entitled to vote in the election of a trustee in bankruptcy of a New York limited partnership where the Bankruptcy Act, the law of New York and the limited partnership agreement require that all creditors be paid in full before any payments are made to a limited partner — either on account of capital contribution or other claim?

Statutes Involved

The statutes involved are sections 5g, 44a and 378(1) of the Bankruptcy Act and sections 102, 104, 105(1) and 112 of the New York Partnership Law and are set forth in the appendix hereto, *infra*.

Statement

Ira Haupt & Co. (Haupt), a New York limited partnership and a member firm of the New York Stock Exchange, was engaged in the stock brokerage business until November 20, 1963, when it was suspended by the Exchange (14b, 22b).[1] The capital of Haupt had been abruptly wiped out as a result of the vegetable oil debacle involving Allied Crude Vegetable Oil Refining Corp. (7b, 22b). By November 25, 1963, Haupt's liabilities were more than $25,000,000 greater than its assets (15b).

The creditor banks of Haupt (including respondents), whose claims against Haupt then exceeded $33,000,000 (7b), entered into an agreement with the Exchange and the general partners with a view to the protection of Haupt's public customers and the orderly liquidation of the partnership (14b-15b). Under this agreement the Exchange contributed $9,500,000 to pay Haupt's customers, and the banks deferred their claims to the extent of $19,000,000 (*ibid.*). By March 10, 1964, almost all of Haupt's 20,000 customers had been paid in full (15b-17b).

In February of 1964, three of Haupt's 13 limited partners (who are also petitioners here) applied to the New York State Supreme Court for the appointment of a receiver of Haupt (14b, 16b). Upon the denial of that application, the three limited partners filed an involuntary petition in bankruptcy against Haupt (16b). Thereafter, on March 30, 1964, a petition for an arrangement under Chapter XI of the Bankruptcy Act was filed by certain of the general partners of Haupt (*ibid*).

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[1] References are to pages of Appendix B of the petition unless otherwise indicated.

At the first meeting of creditors in the Chapter XI proceeding held on April 27, 1964, claims were voted for the nomination of a trustee to be appointed by the Court in the event it became necessary to administer the estate in bankruptcy (23b-24b). Claims of five limited partners (petitioners here) totaling $1,795,861.15 were voted for Abraham M. Glickman (counsel for petitioner Heyman) (30b-31b). All ten of the other creditors present at the meeting (including respondents) voted claims totaling $11,417,174.61 in favor of Edward Feldman (33b). The referee disallowed the limited partners' claims for voting purposes, ruled that Mr. Feldman was nominated on the basis of one claim as to which no objection had been raised, decided it was unnecessary to consider objections to other claims voted for Mr. Feldman, reserved ruling on Mr. Feldman's qualifications, and dismissed the Chapter XI petition (33b-34b, 37b).

The referee's decision disenfranchising petitioners at the election in which Mr. Feldman was nominated was affirmed by the District Court (13b-21b) and the Court of Appeals (3b-12b), which also denied petitions for rehearing (1b) and rehearing in banc (2b). It is from that determination that petitioners seek review by this Court.

On June 26, 1964, the referee disqualified Mr. Feldman "on the ground that he was too closely connected with the debtor,"[2] and announced that at the first meeting of creditors in the bankruptcy proceeding the "creditors would be given an opportunity to elect a trustee. . . ."[3] A new election was held at the first adjourned meeting of creditors in the bankruptcy proceeding on September 11, 1964.[4] Thirty claims (including respondents') totalling $19,118,549.06 were voted for Prof. Charles Seligson; four claims representing $636,557.99 were voted for Samuel Adelman; and seven limited partners (including petitioners) with claims of $2,787,660.31 voted for their prior nominee, Mr. Glick-

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[2] In re Ira Haupt & Co., 240 F.Supp. 10, 13 (S.D.N.Y. 1965).

[3] *Ibid.* at p. 13, n. 1.

[4] *Ibid.* at p. 14.

man.[5] The referee again ruled that the limited partners were not entitled to vote, provisionally disallowed all claims voted for Prof. Seligson as to which objections had been made except those of nine former employees of Haupt, and ruled that Prof. Seligson had been elected trustee.[6]

On petition for review of the referee's decision, the District Court affirmed the appointment of Prof. Seligson as trustee and ruled that the limited partners were not entitled to vote.[7] The Court also held that the Exchange and the banks had been improperly disenfranchised as parties in control of the bankrupt.[8] This did not, however, affect the election of the trustee as the Exchange and the banks had voted for Prof. Seligson.[9]

Finally, Prof. Seligson has been acting as trustee of Haupt for almost a full year.[10] His qualifications are unquestioned, and even petitioners "have praised [his] ability and integrity. . . ."[11]

ARGUMENT

I

The question presented by the petition is moot.

The petition raises only the issue of whether petitioners were properly disenfranchised in the Chapter XI election of Mr. Feldman as trustee. Although the petition is silent on this point, the Chapter XI election was inconclusive. Mr. Feldman received a majority of votes in both number and amount, but he was subsequently disqualified by the referee. A second election was not held in the Chapter XI

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[5] *Ibid.*
[6] *Ibid.* at pp. 14-15.
[7] *Ibid.* at pp. 31-32.
[8] *Ibid.* at pp. 17-18.
[9] *Ibid.* at p. 14.
[10] *Ibid.* at p. 31.
[11] *Ibid.* at p. 31, n. 56.

proceeding because by the time Mr. Feldman was disqualified, the Chapter XI petition had been dismissed and Haupt adjudicated a bankrupt. Since no trustee had been elected and qualified in the Chapter XI proceeding, the referee properly called for a new election at the first meeting of creditors in the bankruptcy proceeding. 8 Collier, Bankruptcy ¶ 5.49, p. 782 (14th ed.); see also *In re Dejay Stores, Inc.*, 220 F. Supp. 497, 502 (S.D.N.Y. 1963).

Petitioners participated in the second election and were again disenfranchised (and out-voted in number and amount), but the validity of that election is not before this Court. Indeed, it has not even been reviewed by the Court of Appeals. Stated simply, petitioners are asking this Court to review the propriety of a prior election in which the trustee elected by others was disqualified and which has been superseded by a subsequent election. Moreover, the second election resulted in the appointment of Prof. Seligson as trustee whom petitioners "have praised [for his] ability and integrity. . . ."[12]

In view of the conceded qualifications of Prof. Seligson, the petition understandably avoids making any claim that his election has prejudiced the administration of the bankrupt or is not in the best interests of all creditors. Whether or not petitioners were properly disenfranchised in the first election, no conceivable purpose could be served by further review of that proceeding since the first election was inconclusive and a new election has in fact been held as required by sections 44a and 378(1) of the Bankruptcy Act.

II

The decision below is clearly correct.

Petitioners' restrictive interpretation of section 44a of the Bankruptcy Act is contrary to the general scheme of the Act and inconsistent with the specific provisions of section 5g. Under section 5g (Appendix, *infra*, p. A-1) a

[12] *Ibid.*

limited partner is entitled to payment only after all partnership debts are paid and then in the order of distribution as provided by the applicable state laws. Petitioners have attempted to avoid the New York Partnership Law by quoting only a portion of section 102 to the effect that for certain claims a limited partner may share pro rata with general creditors. Section 102 also provides, however, that no limited partner shall receive any payment "in respect to any such claim . . . if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners." Comparable provisions subordinating a limited partner's claim for profits and capital contribution are set forth in sections 104, 105(1) and 112 of the New York Partnership Law. (Appendix, *infra*, pp. A-2 — A-4.)

Moreover, petitioners' argument that limited partners under New York law have "a right to be treated *pro rata* with other creditors"[13] with respect to their claims as "customers" of Haupt overlooks the fact that petitioners' claims as "customer creditors" are based solely on their capital investments allegedly in excess of the requirements of the Haupt partnership agreement. As the Court of Appeals stated, however, the partnership agreement "makes the debts and liabilities of the partnership to the general creditors superior to those of the limited partners . . ." (9b). Petitioners also ignore the recent decision in *Nexsen* v. *New York Stock Exchange*, 24 A. D. 2d 514, 515, 261 N. Y. S. 2d 780, 783 (2d Dep't 1965), where the Appellate Division stated that a limited partner of Haupt "is not entitled to payment, either on account of his capital contribution or return thereon, or as a creditor, before creditors who are not partners are paid in full or until full payment to them is assured (Partnership Law, §§ 102, 105, 112)."

Equally unpersuasive is petitioners' attempt to dissociate themselves from any attributes of a stockholder. Their interests in Haupt arose from their equity investments and expectations of return on such investments.

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[13] Petition, p. 9.

The claims of each petitioner described "as a general creditor" in the petition (p. 3) represent nothing more than the return of contract capital invested in Haupt, interest thereon, and profit participation.[14] As the New York Court of Appeals pointed out in *Ruzicka* v. *Rager*, 305 N. Y. 191, 197-98, 111 N.E.2d 878, 881 (1953), a limited partner's position is "analogous to that of a corporate shareholder."

A similar view was expressed in *Klebanow* v. *New York Produce Exchange*, 344 F.2d 294, 297 (2d Cir. 1965), where the Court, while acknowledging that a limited partner has some resemblance to a creditor, stated that "in the main, a limited partner is more like a shareholder, often expecting a share of the profits, subordinated to general creditors, having some control over direction of the enterprise by his veto on the admission of new partners, and able to examine books and 'have on demand true and full information of all things affecting the partnership' . . . . That the limited partner is immune to personal liability for partnership debts . . . may distinguish him from general partners but strengthens his resemblance to the stockholder; and even as to his preference in dissolution, he resembles the preferred stockholder." Indeed, in that case petitioners Klebanow and Lewis successfully asserted their right to bring a derivative action on behalf of Haupt, the Court pointing out, however, that "appellants disclaim creditor status in this appeal, although on another, Klebanow v. Chase Manhattan Bank, 343 F.2d 726 (2 Cir. 1965), they assert they are that for the purpose of voting their claims as limited partners in the election of a trustee in bankruptcy." (344 F.2d at 297)

It plainly was never contemplated by the Bankruptcy Act that a trustee would be elected by those whose interests are "too likely to be closely affiliated with the interests of the former management" (12b) and, to that extent, inimical to the interests of the creditors. There is no reason to assume that a trustee elected by a group of equity investors,

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[14] See petitioners' appendix in Court of Appeals, p. A48.

who can share in the estate only after all creditors are paid in full, will administer the bankrupt in the best interest of the creditors.

Conclusion

Review by this Court of an election proceeding which was inconclusive could serve no purpose especially since a second election has already been held. Moreover, the labelling of petitioners' claims as "creditor claims" cannot change the fact that petitioners seek only a return of their capital investment in Haupt and were properly disenfranchised. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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September 27, 1965

APPENDIX

Bankruptcy Act, Section 5g

The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts and the net proceeds of the individual estate of each general partner to the payment of his individual debts. Should any surplus remain of the property of any general partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be distributed among the individual partners, general or limited, or added to the estates of the general partners, as the case may be, in the proportion of their respective interests in the partnership and in the order of distribution provided by the laws of the State applicable thereto.

Bankruptcy Act, Section 44a

The creditors of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of other similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, appoint a trustee or three trustees of such estate. If the creditors do not appoint a trustee or if the trustee so appointed fails to qualify as herein provided, the court shall make the appointment. If the bankrupt is a face-amount certificate company, as defined in section 4 of the Investment Company Act of 1940, the court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard.

Bankruptcy Act, Section 378(1)

Upon the entry of an order directing that bankruptcy be proceeded with —

(1) in the case of a petition filed under section 321 of this title, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed.

New York Partnership Law, Section 102

Loans and other business transactions with limited partner

(1) A limited partner also may loan money to and transact other business with the partnership, and, unless he is also a general partner, receive on account of resulting claims against the partnership, with general creditors, a pro rata share of the assets. No limited partner shall in respect to any such claim

(a) Receive or hold as collateral security any partnership property, or,

(b) Receive from a general partner or the partnership any payment, conveyance or release from liability, if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners.

(2) The receiving of collateral security, or a payment, conveyance or release in violation of the provisions of subdivision one is a fraud on the creditors of the partnership.

New York Partnership Law, Section 104

Compensation of limited partner

A limited partner may receive from the partnership the share of the profits or the compensation by way of income stipulated for in the certificate; provided, that after such payment is made, whether from the property of the partnership or that of a general partner, the partnership assets are in excess of all liabilities of the partnership except lia-

bilities to limited partners on account of their contributions and to general partners.

New York Partnership Law, Section 105(1)

Withdrawal or reduction of limited partner's contribution

(1) A limited partner shall not receive from a general partner or out of partnership property any part of his contribution until

(a) All liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid or there remains property of the partnership sufficient to pay them.

(b) The consent of all members is had, unless the return of the contribution may be rightfully demanded under the provisions of subdivision two, and

(c) The certificate is cancelled or so amended as to set forth the withdrawal or reduction.

New York Partnership Law, Section 112

Distribution of assets

(1) In settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order:

(a) Those to creditors, in the order of priority as provided by law, except those to limited partners on account of their contributions, and to general partners.

(b) Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions.

(c) Those to limited partners in respect to the capital of their contributions.

(d) Those to general partners other than for capital and profits.

(e) Those to general partners in respect to profits.

(f) Those to general partners in respect to capital.

(2) Subject to any statement in the certificate or to subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contributions respectively, in proportion to the respective amounts of such claims.